

1. Study the extract and answer the questions that follow.

New drought threat to economy

- ① Farmers and economists are praying for rain.
- ② Australia recorded the lowest rainfall in 40 years in the four months from 1st January to the end of April and, if there is not substantial rain in the next four weeks, 60 per cent of the winter grain crop is threatened.
- ③ Some farmers have yet to recover from the devastation to their winter crop in 2002. That drought resulted in the value of rural exports slumping by almost 30 per cent in the year to mid 2003 and cut about one per cent off Australia's **real output**.
- ④ Economists say the time for planting the winter crop is rapidly closing, but dry subsoil conditions mean farmers are holding off. Many farmers have not fully recovered from the last drought, as total farm exports have remained almost 13 per cent below the record highs of 2002.
- ⑤ Rainfall in the four months from January to April has been the lowest since 1965, and the second lowest since 1950. The lack of rain means beef farmers cannot keep their cattle on pasture, and this has resulted in soaring cattle sale numbers. As a result, the price per kilo beef farmers are receiving is down. At the peak of the **trade cycle** farmers were getting \$2.20 a kilogram, but are now receiving \$1.85 a kilogram.
- ⑥ Government intervention has been widely called for, yet the form it should take has been hotly debated. The main form of government support would be income relief in the form of unemployment benefits for up to two years for those most affected by the drought. A second form of aid would involve an interest rate subsidy, which would allow farmers to borrow finance at a discounted rate. A third form of intervention could be price controls for products such as milk. A fourth form of aid would involve financial assistance for infrastructure improvements. Critics of government intervention have argued that the market system should be left alone to resolve issues of resource allocation.

[Source: *The Sunday Age*, 8 May 2005 and *The Age*, 21 May 2005]

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(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) real output (*paragraph 3*) [2 marks]
 - (ii) trade cycle (*paragraph 5*). [2 marks]
- (b) Using an appropriate diagram, explain how the drought has impacted on the Australian beef market. [4 marks]
- (c) Using an appropriate diagram, explain how the drought may impact on the exchange rate of the Australian dollar. [4 marks]
- (d) Using information from the text and your knowledge of economics, evaluate the consequences of possible government intervention to reduce the economic impact of severe droughts in Australia. [8 marks]